

Message Text

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ACTION EA-09

INFO OCT-01 IO-13 ISO-00 CIAE-00 DODE-00 PM-04 H-02
INR-07 L-03 NSAE-00 NSC-05 PA-02 PRS-01 SP-02
SS-15 USIA-15 AID-05 TRSE-00 OMB-01 STR-04 AGRE-00
ACDA-10 EB-07 COME-00 /106 W
-----130754Z 094226 /11

R 130630Z MAY 77
FM AMEMBASSY SEOUL
TO SECSTATE WASHDC 3872
INFO AMEMBASSY TOKYO
AMEMBASSY TAIPE
AMCONSUL HONG KONG
U.S. MISSION GENEVA 413
U.S. DEL MTN GENEVA

UNCLAS SECTION 1 OF 2 SEOUL 3991

HONG KONG FOR REGFINATT

E.O. 11652: N/A
TAGS: ETRD, EFIN, MTN, GATT, KS
SUBJECT: KOREAN ECONOMY: STRONG EXTERNAL SECTOR; SLUGGISH
DOMESTIC ACTIVITY

REF: SEOUL##

SUMMARY: CONTINUED STRONG RESULTS FROM THE EXTERNAL SECTOR
ARE MASKING GENERALLY SLUGGISH DOMESTIC ECONOMIC ACTIVITY
FOR THE KOREAN ECONOMY. POLICY RESPONSES SO FAR ARE
CONSTRAINED BY THE NEED TO SIMULTANEOUSLY DEAL WITH
CONTINUED INFLATIONARY PRESSURES AND EXCESSIVE MONETARY
EXPANSION. END SUMMARY.

1. APRIL DATA ON THE KOREAN ECONOMY SHOW THE EXTERNAL
SECTOR STILL THE CARRYING THE LOAD, MASKING A GENERALLY
SLUGGISH DOMESTIC ECONOMIC PERFORMANCE. INCLUDING
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APRIL TOTALS OF \$747 MILLION AND \$887 MILLION, KFX
EXPORTS AND EXPORT LETTER-OF-CREDIT ARRIVALS (L/CS)
RESPECTIVELY ARE UP 40 PERCENT AND 23 PERCENT OVER A YEAR
EARLIER, A PACE THAT IS CONSISTENT WITH THE YEAR'S \$10
BILLION EXPORT TARGET. THE MOST IMPRESSIVE FEATURE OF
THE EXPORT PERFORMANCE TO DATE IS THAT IT HAS BEEN
ACCOMPLISHED WITH ONLY MODEST HELP FROM THE NORMALLY

CURCIAL TEXTILE SECTOR. TEXTILE EXPORTS FOR THE FIRST QUARTER WERE UP ONLY 25 PERCENT WHILE TEXTILE L/C ARRIVALS WERE A MERE 1 PERCENT ABOVE JAN-MARCH 1976.

2. APRIL KFX IMPORTS REMAINED UNUSUALLY LOW AT \$635 MILLION WITH KFX IMPORT LICENSES FINISHING AT \$760 MILLION. AIDED BY A STRONG PERFORMANCE IN THE SERVICES ACCOUNT, THE FOREIGN EXCHANGE, OR PARTIAL, CURRENT ACCOUNT SURPLUS FOR THE FIRST FOUR MONTHS WAS A STUNNING \$539 MILLION COMPARED TO A VIRTUAL BALANCE FOR THE SAME PERIOD A YEAR AGO. WHILE OVERALL BALANCE OF PAYMENTS DATA ARE NOT YET AVAILABLE, UNOFFICIAL GOVERNMENT ESTIMATES SHOW KOREA RUNNING A SURPLUS OF ROUGHLY \$50 MILLION ON THE OVERALL CURRENT ACCOUNT FOR THE FIRST QUARTER, NORMALLY THE SEASONALLY WEAKEST QUARTER FOR CURRENT ACCOUNT PERFORMANCE.

3. DESPITE THE HEALTHY EXPORT DEMAND, KOREA'S CUMULATIVE INDUSTRIAL PRODUCTION INDEX, NOW AVAILABLE THROUGH MARCH, WAS UP ONLY 13.5 PERCENT OVER THE SAME THREE MONTHS OF 1976. DOMESTIC CONSTRUCTION ACTIVITY WAS ESPECIALLY WEAK WITH BUILDING PERMITS FOR THE QUARTER DOWN 46 PERCENT FROM A YEAR AGO. REFLECTING THE DULL DOMESTIC ECONOMIC ACTIVITY, THE OVERALL WARNING INDICATOR, A COMPOSITE OF ECONOMIC INDICATORS, REMAINED AT A FLAT 1.4 READING FOR MARCH. LOCAL OBSERVERS ATTRIBUTE THE SLUGGISHNESS OF DOMESTIC DEMAND, PARTICULARLY IN THE CONSTRUCTION SECTOR, TO A VARIETY OF FACTORS THAT HAVE CREATED A CLIMATE OF UNCERTAINTY THAT IS DELAYING INVESTMENT

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AND PURCHASING DECISIONS. THESE FACTORS RANGE FROM SUCH SOLELY DOMESTIC CONCERNS AS THE ANNOUNCEMENT OF PLANS FOR MOVING THE ADMINISTRATIVE CAPITAL OUT OF SEOUL AND A DEBATE OVER TAXATION POLICY ON CAPITAL GAINS ON HOUSING TO SUCH BROADER ISSUES AS THE THREAT OF INCREASED PROTECTIONISM ABROAD AND THE IMPLICATIONS OF THE WITHDRAWAL OF U.S. GROUND TROOPS.

NOTE BY OC/T: ##AS RECEIVED.

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4. ROKG POLICY RESPONSES FOR THE WEAKNESSES IN DOMESTIC DEMAND HAVE BEEN CONSTRAINED SO FAR BY FACT THAT POLICY MAKERS ARE SIMULTANEOUSLY FACED WITH THE CONTRADICTIONARY PROBLEMS OF CONTINUING INFLATIONARY PRESSURES AND EXCESSIVE MONETARY EXPANSION. ALTHOUGH THE PACE OF INCREASES IN PRICES AND MONEY SUPPLY SLOWED IN APRIL, THE RESULTS FOR THE FOUR MONTHS AS WHOLE CONTINUE TO BE A MATTER OF CONCERN. WHOLESAL AND CONSUMER PRICES THROUGH APRIL HAVE RISEN 4.3 PERCENT AND 4.6 PERCENT RESPECTIVELY AGAINST TARGETED INCREASES OF 10 PERCENT FOR THE FULL YEAR FOR BOTH INDICES. WHILE TAX OFFICIALS ARE STILL ATTEMPTING TO REFINE ESTIMATES OF THE LIKELY IMPACT ON DOMESTIC PRICES OF THE SCHEDULED JULY 1 INTRODUCTION OF A VALUED ADDED TAX (VAT), THEIR PRELIMINARY WORK SUGGESTS THAT V.A.T. IS LIKELY TO PUSH UP WHOLESAL PRICES BY ROUGHLY 2 PERCENT. ECONOMIC PLANNING BOARD (EPB) OFFICIALS ADAMANTLY ZDENY PRESS STORIES THAT THE GOVERNMENT IS SERIOUSLY CONSIDERING RAISING THE OFFICIAL PRICE TARGETS FOR THE YEAR FROM 10 PERCENT TO 12 PERCENT, BUT CONCEDE THAT HOLDING PRICE GAINS WITHIN THE ORIGINAL TARGETS WILL BE AN ALMOST IMPOSSIBLE TASK
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UNLESS MONETARY GROWTH CAN BE HELD ON A MUCH TIGHTER LEASH OVER THE FINAL EIGHT MONTHS OF THE YEAR.

5. THE COMBINATION OF RISING NET FOREIGN ASSETS AND THE FERTILIZER SUBSIDY, MEANWHILE, HAVE PRODUCED A 6.4 PERCENT EXPANSION IN MONEY SUPPLY (M-1) FOR THE YEAR TO DATE, A PERIOD WHEN SEASONAL FACTORS NORMALLY KEEP MONETARY GROWTH IN CHECK. IN AN EFFORT TO SLOW THE FURTHER GROWTH OF FOREIGN EXCHANGE RESERVES, UP \$280 MILLION SINCE DECEMBER 31 TO

\$3,241 MILLION AS OF APRIL 30, THE MINISTRY OF FINANCE ON MAY 12 ANNOUNCED NEW GUIDELINES FOR FOREIGN EXCHANGE FINANCING AIMED AT STABILIZING THE NET INFLOW OF SHORT-TERM FINANCING AND INCREASING FOREIGN EXCHANGE FUNDING FROM KOREA'S OWN RESERVES (DETAILS WILL FOLLOW BY SEPTTEL). THE ECONOMIC PLANNING BOARD, IN TURN, IS CITING THE INFLATIONARY PRESSURES AND EXCESSIVE MONETARY GROWTH AS COMPELLING ARGUMENTS FOR PRESSING FORWARD WITH IMPORT LIBERALIZATION FOR THE SECOND HALF OF 1977, A CASE THAT APPEARS TO BE GROWING STRONGER WITH EACH PASSING MONTH.
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